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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 889

ESTATE OF R. A. SEWELL, JOSEPHINE M. SEWELL, EXECUTRIX, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 34–78) is not officially reported. The opinion of the Circuit Court of Appeals (R. 206–209) is reported at 151 F. 2d 806.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 9, 1945 (R. 209) and a petition for rehearing (R. 210–217) filed on November 29, 1945, was denied on December 28, 1945 (R. 218). The petition for a writ of certiorari was filed on February 26, 1946. The

jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. The Tax Court determined that the taxpayer did not intend to make a completed gift to his wife of certain income producing property and that he was not thereby relieved from liability for the tax imposed on the income by Sections 11 and 22 (a) of the Revenue Acts of 1934 and 1936.

Did the Circuit Court of Appeals err in deciding that the Tax Court's conclusions were supported by the evidence?

2. The Tax Court determined that a partnership did not, for tax purposes, exist between taxpayer and his wife and children, and that all the profits from the purported partnership were taxable to the taxpayer.

Did the Circuit Court of Appeals err in holding that the decision of the Tax Court was supported by the evidence?

STATUTES INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 11. NORMAL TAX ON INDIVIDUALS.
>
> There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *.
>
> * * * * *

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from * * * professions, vocations, trades, businesses, commerce, * * * or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, * * * dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

The corresponding provisions of the Revenue Act of 1936, c. 690, 49 Stat. 1648, are identical.

STATEMENT

This case involves the income tax liability of R. A. Sewell (hereinafter referred to as the taxpayer) for the taxable years 1934–1937, inclusive. This case arises from a consolidated proceeding before the Tax Court from which a separate petition for review was taken to the Circuit Court of Appeals for the Fifth Circuit.[1] The facts found by the Tax Court relating to the present proceeding may be summarized as follows:

[1] A separate petition to review the Tax Court's determinations respecting the liability of the taxpayer's two brothers resulted in an affirmance. *Sewell* v. *Commissioner*, 151 F. 2d 765 (C. C. A. 5th), certiorari denied, February 25, 1946, No. 754, this Term. That case presented issues similar to the first issue here involved.

The taxpayer was one of the principal stockholders of the Sewell Manufacturing Company. In 1934, at the taxpayer's direction, the accountant for the company prepared five stock certificates for a total of 1,000 shares of stock of the company in the name of the taxpayer's wife, Josephine M. Sewell; certificates for a like amount of shares which were standing in the taxpayer's name were cancelled. The taxpayer's wife was not present at the time of the issuance of the certificates and has never had possession of them. The certificates were at all times attached to their stubs in the company's stock book. The taxpayer advised his wife that he had made a gift of the stock. (R. 37–38.) In a similar manner in 1936, 300 shares were issued to the taxpayer's wife, and two certificates for the same number of shares which were then in the taxpayer's name were cancelled. (R. 38.) Gift taxes were paid on these purported gifts. (R. 38–39.)

The taxpayer's wife took no part in the management or in the business of the company; she did not have notice of or attend any stockholders' meetings, but did come to the office occasionally and had access to the company's vault which was left open during business hours. At the time of, or subsequent to the issuance of the certificates, she endorsed them in blank, some of the endorsements not having been made until the times when her shares were sold. (R. 39.)

During the years 1934 through 1936, dividends in the total amount of $47,006.60 were credited on the books of the company to the account of the taxpayer's wife. There was also credited to her account $175,768.72 which resulted from the proceeds of sales or of loans of the stock standing in her name. (R. 40–41.) During the taxable years there was transferred on the books of the company to the taxpayer's account from his wife's account the amount of $222,255.44. (R. 41–42.) The only other debit to the taxpayer's wife's account was for certain taxes paid for her. (R. 42.) These transfers were made by the company's bookkeeper who in some instances did so at the direction of the taxpayer and in others without any specific authorization. The taxpayer's wife knew that the taxpayer made some use of the dividends standing to her credit and agreed that he could do so at any time he needed money. (R. 43.) The taxpayer did not execute any promissory notes for the amount so transferred and he used the money, together with other funds, for the organization of a hat manufacturing business and for the construction and building of its plant. (R. 44.) In filing credit statements with certain banks to show the financial condition of this company, the taxpayer did not disclose that his wife had any financial interest therein, or that he was indebted to her. (R. 46.)

In transferring the stock the taxpayer did not intend to vest in his wife dominion and control over the shares, but intended to and did retain that control and dominion in himself. The taxpayer's wife knew that such an intention existed and impliedly agreed that the taxpayer should retain control of the stock that was issued in her name. (R. 46.) The Tax Court specifically found that (R. 46) "Completed gifts of the stock certificates so transferred were not made." As a result, the Tax Court concluded that the dividends on the stock were taxable to the taxpayer. (R. 47–52.)

During the years 1934 through 1936, gains were realized from the sale or exchange of certain of the stock which was standing in the name of the taxpayer's wife. (R. 57–59.) Pursuant to its conclusion that completed gifts of the stock had not been made, the Tax Court determined that such gains were taxable to the taxpayer. (R. 59–62.) The Circuit Court of Appeals affirmed on the ground that the Tax Court's conclusion was supported by the evidence. (R. 208–209.)

By the close of the year 1935, the taxpayer had invested $107,803.64 in a business known as the Sewell Hat Manufacturing Company, this amount having been transferred from his wife's account in the Sewell Manufacturing Company; he also invested an additional amount of $54,220.41. By the close of 1936, he had also invested $114,451.80 transferred from his wife's account during that

year and the additional amount of $84,726.66. (R. 62.)

In the fall of 1935, the taxpayer became seriously ill and his brother purchased the hat business, agreeing to reconvey it to the taxpayer at the same price whenever the taxpayer should desire. In the early part of 1936, the taxpayer requested and obtained a reconveyance of the business. An operating loss of $18,000 was sustained by the company in 1935 and the entire amount of the loss was claimed as a deduction by the taxpayer in his individual tax return for 1935. (R. 62–63.)

Although, in 1936, the taxpayer told his business associates that the hat business was being operated as a partnership, he represented himself as the sole owner in certain financial statements. The capital account in the company's ledger was opened on August 31, 1935, under the caption "Investment—Capital—R. A. Sewell". (R. 63.) In March, 1937, on instructions from the taxpayer, the bookkeeper added the words "and family" to the caption. At about the same time, and also upon the taxpayer's instructions, the bookkeeper inserted a sheet in the ledger showing a credit balance in the capital account as of December 31, 1936 (R. 63):

R. A. Sewell	$159,025.27
Josephine M. Sewell	159,025.27
R. A. Sewell, Jr	15,818.39
Joseph Sewell	15,417.24
Hugo Sewell	15,435.26
Helen Virginia Sewell	15,377.23

These figures were given to the bookkeeper by the accountant who was retained to examine the books for the preparation of a 1936 income tax return. On March 19, 1937, the accountant prepared a gift tax return for the taxpayer's wife on which she reported gifts on January 1, 1936, of separate $15,000 interests in the company to each of her four children. (R. 63–64.) A partnership return for the company prepared by the same accountant and executed on March 19, 1937, reported net income of $10,311.05, of which 40% was distributable to the taxpayer, 40% to his wife, and 5% each to the four children. The taxpayer's wife filed a tax return for 1936, which was prepared by the same accountant, but did not report any amount as her distributive share of the profits of the purported partnership. (R. 64.)

At about the time that these income and gift tax returns were under preparation, the accountant instructed one of his employees to prepare a trust agreement covering gifts from the taxpayer's wife to her four children. The trust instrument was completed on May 27, 1937 but bore the date of June 1, 1936. The instrument named the taxpayer and his wife as trustees and provided, in part, as follows (R. 64–65):

> Whereas, the party of the first part has this day purchased and paid for a three-fifths (3/5) undivided interest in a certain business, known as the Sewell Hat

Manufacturing Company, located at Red Oak, Fulton County, Georgia, and whereas the undersigned desires to convey in trust for each of her following minor children, to-wit: Robert A. Sewell, Jr., Joseph Sewell, Hugo Sewell and Helen Sewell, an undivided one-twentieth (1/20) interest in and to all of the assets of said business, and all profits therein accruing from and after this date, upon the terms, conditions and powers hereinafter set forth, and

Whereas, the undersigned desires that her husband, Robert A. Sewell, who is the owner of two-fifths (2/5) undivided interest in the business, continue the active management and control of said business, both for himself and for the benefit of said minor children, and for the benefit of the party of the first part,

Now Therefore, the party of the first part, in consideration of love and affection, does hereby transfer and convey unto herself and Robert A. Sewell, as Trustees for said named minor children, a one-fifth (1/5) interest, i. e., a one-twentieth (1/20) interest for each minor child, in and to said partnership, upon the following terms, conditions and powers, hereinafter set forth, that is to say:

1. The party of the first part does constitute, select, and appoint herself and husband, Robert A. Sewell, as Trustee for each of said described children during their minority, the said Trustees to hold legal title to said respective partnership

> interests and assets, for the use and benefit of said minor children, and the said business shall continue from and after this date as a partnership consisting of the party of the first part owning an undivided two-fifths (2/5) interest, her said husband, Robert A. Sewell, owning an undivided two-fifths (2/5) interest, and the aforesaid Trustees holding the legal title for each of said minor children, to an undivided one-twentieth (1/20) interest for the use and benefit of said children.

The taxpayer's wife subsequently signed the instrument. It was later lost and has never been recovered. On October 16, 1940, she executed a carbon copy of the original. (R. 66.)

During the time that the trust agreement was under preparation, the employee who drafted it was also engaged in the preparation of a limited partnership agreement between R. A. Sewell, individually, as general partner, and Josephine M. Sewell, individually, and R. A. Sewell and Josephine M. Sewell, as trustees for their four children, as limited partners. The final draft was completed about the same time as the trust agreement and was executed under the date of July 1, 1937. It provided that the taxpayer and his wife should each contribute to the capital of the limited partnership their separate undivided two-fifths interest in the Sewell Hat Maufacturing Company, and that, as trustees for their children, they should contribute four undivided one-twentieth

interests; that profits and losses should be divided in proportion to the capital contributions; that the taxpayer should have active charge of the conduct of the business, and be paid a salary not to exceed 40% of the net income of the business; and that in the event of his death, the partnership should terminate. (R. 66.) There had been no written partnership agreement affecting the hat business prior to the execution of the trust agreement and the limited partnership agreement in 1937. (R. 66.)

Under date of September 30, 1937, the capital investment accounts of the taxpayer and his wife were debited $20,000 each, and credits of $10,000 each were entered in the accounts of each of the four children. At that time, it was agreed that the distributive share of profits of each child should be 8⅓ percent. (R. 66.) A partnership return for the Sewell Hat Manufacturing Company for 1937 reported net income of $42,889.95, before payment of salaries of $8,400 to the taxpayer and $3,000 to his wife, leaving a balance of $31,489.95, distributable as follows (R. 67):

R. A. Sewell	$10,496.55
Jos. M. Sewell	10,496.55
R. A. Sewell, Jr.	2,624.22
Joseph Sewell	2,624.21
Hugo Sewell	2,624.21
Helen V. Sewell	2,624.21

The taxpayer's wife reported the amount of $13,496.55 as income from the hat business on her individual return for 1937. The amounts reported as her distributive share of the profits

and that of the four children, less withdrawals, were transferred in each of the taxable years and in subsequent years to the credit of their respective capital accounts. In 1937 withdrawals in the amount of $18,763.46 were charged to the taxpayer's wife, and of $47.50 to each of the four children. (R. 67.)

The taxpayer died on January 16, 1940. Thereafter the hat business was operated by his widow and the children. In 1942 it was incorporated and has been operated as a corporation since that time. (R. 67.)

The Commissioner determined that taxable income from the hat business was $11,670.43 in 1936 and $43,323.93 in 1937, and that the entire income for each year was taxable to the taxpayer. (R. 67.)

The Circuit Court of Appeals (R. 208–209) affirmed the conclusion of the Tax Court (R. 67–71) that the taxpayer was the sole owner of the business during the taxable years and the income therefrom was taxable to him.

ARGUMENT

1. Whether the taxpayer intended to make a completed gift of the stock in the Sewell Manufacturing Company to his wife, and whether he relinquished dominion and control over the shares or retained substantial ownership with respect to this property, were questions of fact for the determination of the Tax Court. *Commissioner*

v. *Court Holding Co.*, 324 U. S. 331; *Helvering* v. *Clifford*, 309 U. S. 331; *Dobson* v. *Commissioner*, 320 U. S. 489, 494, rehearing denied, 321 U. S. 231. The Circuit Court of Appeals, quite properly, reviewed only the evidence to determine whether it supported the Tax Court's conclusion. In view of the facts set forth in the statement, *supra*, there was more than sufficient evidence to sustain a finding that the taxpayer never intended to make a gift of the stock to his wife.

2. The decisions of this Court in *Commissioner* v. *Tower* and *Lusthaus* v. *Commissioner*, Nos. 317 and 263, this Term, decided February 25, 1946, demonstrate, beyond any question, that the courts below decided the family partnership issue correctly. There was ample evidence from which the Tax Court could conclude that all funds invested in the hat business always belonged to the taxpayer, that his wife did not purchase any interest in the business in 1936, that the 1937 trust agreement, under which she declared herself to be trustee for their children, was without foundation when it recited that she had purchased an interest in the hat business, and that the 1937 limited partnership agreement between the taxpayer, his wife, and their children was also not of probative value in its statement that she had an interest in the hat business. (R. 69–70.)

There was no contention before the Tax Court that the taxpayer had given his wife an interest

in the partnership either in 1936 or in 1937. Moreover, there was no documentary evidence of such a transfer and the Tax Court was justified in finding that not even a formal gift to the wife had been made. But even if there had been such a gift, this additional fact would not have been sufficient to alter the decision reached. *Commissioner* v. *Tower, supra* and *Lusthaus* v. *Commissioner, supra.*

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully.

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MARCH 1946.

U. S. GOVERNMENT PRINTING OFFICE: 1946